89-1534

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1989

NO.

TESLA PACKAGING INC., ORION PACKAGING INC., AND JACEK MUCHA,

Petitioners

V.

HERBERT E. RUBIN AND PACKAGING EQUIPMENT SYSTEMS, INC.,

Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Jeannine Turgeon, Esquire
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130 State Street
P. O. Box 1000
Harrisburg, Pennsylvania 17108-1000
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Attorneys for Petitioners

I. QUESTION FOR REVIEW

Whether the doctrine of recoupment is to be applied in a bankruptcy proceeding, under the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. Section 101 et. seq., in which a creditor's pre-petition claim against a bankrupt debtor and a debtor's post-petition claim against a creditor are deemed to have arisen from the same transaction or cause of action?

Suggested Answer: Yes.

II. TABLE OF CONTENTS

III. TABLE OF AUTHORITIES

Cases

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IV. UNOFFICIAL REPORT OF OPINIONS

This is an appeal from the United States District Court for the Middle District of Pennsylvania, Memorandum Opinion, filed June 27, 1989, William W. Caldwell, United States District Judge, which was affirmed by Judgment Order entered on December 21, 1989 by the United States Court of Appeals for the Third Circuit.

V. JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was entered on December 21, 1989.

The jurisdiction of this Court is invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, codified at 28 U.S.C. §1254(1).

VI. STATEMENT OF THE CASE

On or about August, 1985, Respondent, Packaging Equipment Systems, Inc., a Pennsylvania corporation, by and through its president, Herbert E. Rubin, entered into a business arrangement with Petitioner, Orion Packaging, Inc., a Canadian corporation, which manufacturers packaging machines by and through its president, Jacek Mucha. The business arrangement related to Respondent's sale and distribution of Petitioner's packaging machines, which are utilized by various companies to wrap their products for transportation and/or sale. The business arrangement between Respondent and Petitioner was never reduced to writing, but was based entirely on business practices and oral agreements.

Under the business arrangement, Respondent would order machines from Petitioner for distribution and sell them to companies in the United States. At all times, Respondent remained free to negotiate the sales price of the machines with its customers, constrained only by the cost of the machines from Petitioner, plus shipping costs and Respondent's own overhead costs. (Stipulated Facts #13, App. 10a) Respondent thus determined its own sales commission or profit.

After Respondent sold a Petitioner's machine, Respondent would advise Petitioner and Petitioner would ship the machine directly to the buyer. Respondent would invoice the customers directly, based upon the retail sales price for the Petitioner machines as quoted by Respondent. At all times throughout Petitioner's and

Respondent's business relationship, Respondent's profit was determined by the difference between wholesale cost of the machines from Petitioner and retail price as agreed with the purchaser, less the shipping charges. (Stipulated Facts,#10 App. 9a)

Pursuant to their business agreement, Respondent collected payment for the Petitioner's machines from its buyers and paid Petitioner the wholesale price plus shipping charges within thirty (30) days from the date Petitioner shipped the machinery to the buyer. (Stipulated Facts #3, App. 8a)

On August 26, 1986, Respondent filed a Petition under Chapter 11 of the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. section 101 et. seq., hereinafter the "Bankruptcy Code". At the time of filing

bankruptcy, Petitioner was Respondent's largest creditor, being owed approximately Two Hundred Thousand and 00/100 ($200,000.00) Dollars. (District Court Opinion, App. 2a) After Respondent filed its bankruptcy petition, the business arrangement between Petitioner and Respondent for the sale of the machines remained substantially the same. Respondent continued to sell Petitioner machines and Respondent continued to negotiate and set the ultimate sales price of the machines for its customers. In fact, Respondent continued to calculate the sales price to its customers. Respondent's profit calculation never changed throughout the entire business relationship with Petitioner, pre- and post-bankruptcy.

Several months after Respondent filed bankruptcy, Petitioner began directly

invoicing Respondent's customers and Petitioner collected the payments directly from the customers. Petitioner then paid Respondent its profit based upon the same calculation as before, the difference between the retail price as set by Respondent and the wholesale cost of the machines plus shipping costs. The amount of profit Respondent received on the sale of each machine was never changed by Petitioner. Respondent and Petitioner continued to operate under the same substantive operating terms pursuant to the original business arrangement. Only the office process of invoicing and collection of payment changed. (Stipulated Facts #11, App. 10a)

The factual scenario which is the matter at issue involves payment of a machine sold to Northland Container. At or

about the time of Respondent's filing of its bankruptcy petition, Petitioner was contacted by Northland Container, one of the companies which purchased Petitioner's machines from Respondent. (Stipulated Facts #1 and 2, App. 8a) Northland Container requested that its account be handled exclusively through Petitioner because Northland Container was displeased with the services they were receiving from Respondent. (Mucha Deposition, p. 120, App. 12a)

On March 12, 1986, prior to the filing of Respondent's Bankruptcy Petition, Northland Container wrote to Respondent and enclosed a purchase order for the purpose of one of Petitioner's machines in the amount of Ninety Thousand Sixty and 00/100 ($90,060.00) Dollars. Respondent invoiced Northland Container for the equipment on

June 27, 1986. Northland Container sent Respondent a payment of Forty-nine Thousand Two Hundred Ninety-two and 30/100 ($49,292.80) Dollars. The $49,292.80 received by Respondent was reported to the Bankruptcy Court on Respondent's monthly financial statement for August of 1986, as a "collection of pre-Chapter 11 receivables." The parties stipulated that of the $49,292.80 received by Respondent from Northland, Respondent owed Petitioner Thirty Thousand Seventy-eight and 00/100 ($30,078.00) Dollars. The $49,292.80 was received by Respondent after it filed bankruptcy. The $30,078.00 Respondent owed to Petitioner was not paid to Petitioner and was claimed by Petitioner as a counterclaim to the aforementioned Respondent's complaint. (Stipulated Facts Nos. 6, 7, 8, & 9, App. 9a)

Petitioner maintains that its pre-petition claim of $30,078.00 against Respondent is subject to recoupment against Respondent's post-petition (post-bankruptcy) claims against Petitioner for its sale of Petitioner's machines. In order for Petitioner to set off the amount it owes Respondent from the amount Respondent owes Petitioner under the law, Petitioner must establish that the debts arose from the "same transaction or cause of action." Petitioner submits, inter alia, that there were no material changes throughout the business arrangement between Petitioner and Respondent and that the pre-petition claims of Petitioner and the post-petition claims of Respondent arose from the same transaction or cause of action, i.e., the 1985 business arrangement, as set forth in the argument, infra.

Petitioners submit that the doctrine of recoupment is to be applied when the creditor's pre-petition claim and the debtor's post-petition claim arose from the same transaction or cause of action. It is further submitted that this does not create a preferred creditor status under the Bankruptcy Code.

The federal jurisdiction in the United States District Court for the Middle District of Pennsylvania was submitted under the United States District Court's original jurisdiction provision, 28 U.S.C. §1332(a)(2) and (c), pursuant to complete diversity of citizenship between the Appellee (Respondents hereto) and Appellant (Petitioners hereto), and that the amount in controversy exceeded the sum of Ten Thousand and 00/100 ($10,000.00) Dollars, exclusive of interest and costs. Respondent, PES, is

a Pennsylvania corporation. Respondent, Herbert E. Rubin, is a citizen of the Commonwealth of Pennsylvania. Petitioners, Orion Packaging, and Tesla Packaging, Inc., are Canadian corporations. Petitioner Jacek Mucha, is a citizen of Canada.

A portion of the claim in said action was a "core" proceeding of a bankruptcy proceeding as defined by section 157(b)(2), of the Bankruptcy Code, 28 U.S.C. section 157(b)(2) inasmuch as it arose in connection with Respondent's proceeding under Chapter 11 of the Bankruptcy Code, titled In Re: Packaging Equipment Systems, Inc., No. 1-86-00885, Bankruptcy Court, Middle District of Pennsylvania.

Petitioners timely appealed the decision of the United States District Court, Middle District of Pennsylvania,

rendered June 27, 1989, by the Honorable William W. Caldwell, to the United States Court of Appeals for the Third Circuit, under Docket No. 89-5637, pursuant to F.R.C.P. 4(a)(1). Jurisdiction for Petitioners' appeal from the final judgment of the District Court to the Third Circuit Court of Appeals was pursuant to 28 U.S.C. §1292(b). On December 21, 1989, the Third Circuit Court of Appeals rendered a Judgment Order affirming the decision of the United States District Court, for the Middle District of Pennsylvania. Petitioners hereby appeal the decision of the Third Circuit Court of Appeals to the United States Supreme Court by Petition for Writ of Certiorari pursuant to the jurisdiction of this Court, invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U.S.C. §1254(1).

VII. ARGUMENT - REASONS FOR GRANTING THE PETITION

(A) CONFLICT WITH OTHER CIRCUIT COURT DECISIONS.

The Third Circuit Court of Appeals' decision in this case, is in conflict with the decision of the Tenth Circuit Court of Appeals in In Re: B&L Oil Company, 782 F.2d 155 (10th Cir. 1986). In that case, the Tenth Circuit Court of Appeals held that the original agreement constituted a "single contract" inasmuch as the debtor-in-possession continued after the bankruptcy to conduct business with the creditor at the same prices and subject to the same other terms as under the parties' original agreement. As referenced in the Statement of the Case, Respondent herein continued to conduct business with the Petitioner herein after the bankruptcy petition was filed and

Respondent continued to receive its profits under the same terms and conditions of the parties' original business agreement.

The Tenth Circuit, in that case, applied the doctrine of recoupment recognizing that recoupment is an equitable doctrine as follows:

> Bankruptcy courts apprise recoupment as an equitable doctrine. Here we face a question of unjust enrichment. Here the debtor-in-possession continued after bankruptcy to make sales to Ashland at the prices and subject to the other terms of the division order. Why should it not take the unfavorable aspects of the order as well -- the obligation to repay earlier overpayments Ashland made? The general principles that a petition for bankruptcy operates as a "cleavage" in time; but the recoupment doctrine has traditionally operated as an exception to the rule when it applies to other debts.
> 782 F. 2d at 159.

Although that case involved overpayments by the creditor to the debtor,

it was nevertheless determined by the Tenth Circuit that because the prices and terms of the original agreement were applicable after the bankruptcy and were in effect during this period of time, the doctrine of recoupment applied. Therefore, the Tenth Circuit Court stated that:

> We have no difficulty holding that the old division order is a single contract, despite the fact that there were month-to-month purchases of oil arising out of the same order. 782 F.2d at 157.

Consequently, the Tenth Circuit Court determined that because the prices and terms of the original contract continued during the post-bankruptcy period, and because the debtor enjoyed all of the benefits of conducting business with the creditor after bankruptcy, the continuing intermittent, month-to-month transactions involving individual purchase orders between the creditor and debtor, did not constitute

single, individual transactions, but all emanated from the terms of the original agreement. The basic rationale of the Tenth Circuit Court was that since the prices used and the terms that governed each and every subsequent order were the same prices and terms as stated in the original contract, all of these additional transactions emanated from the original agreement and thus the same transaction or cause of action.

In the instant action, all of the material terms of the business arrangement between Petitioners and Respondents were governed by the terms of their original 1985 business agreement, and therefore, in accordance with In Re: B&L Oil Company, supra, the post-bankruptcy petition transactions between Petitioner and Respondent were not separate contracts.

Accordingly, the post-bankruptcy sales of Respondent should be construed as emanating from the same transaction or cause of action, thereby allowing recoupment of Petitioners' pre-petition claims against Respondents' post-petition claims.

Furthermore, the Tenth Circuit Court recognized the equitable aspects of the doctrine of recoupment in that a debtor-in-possession, that accepts the benefits of an executory contract, cannot do so without accepting the burdens. Petitioner was the only creditor that Respondents continued to do business with after bankruptcy. Consequently, the Tenth Circuit recognized this type of exceptional circumstance, which is synonymous to the instant action, and permitted the recoupment of the creditor's pre-petition claims against the debtor's post-petition claims.

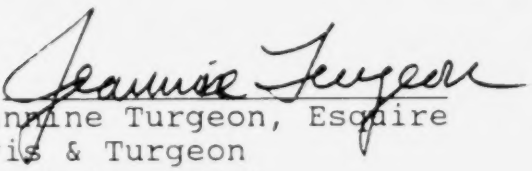
(B) CONCLUSION

The only issue before this Court is whether the doctrine of recoupment should be applied to the pre-petition bankruptcy claims of Petitioners and the post-petition bankruptcy claims of Respondents because they arose from the same transaction or cause of action, i.e., the terms and conditions of the original agreement between the parties.

In conclusion, the doctrine of recoupment is applicable in a case such as the one sub judice, in which a debtor continues to conduct business with a creditor post-bankruptcy, under the same terms and conditions under the original agreement, entered into pre-bankruptcy. Any claims that arise by either party at any time should be held to originate from the same transaction or cause of action, i.e., the original agreement.

Petitioners respectfully submit that the decision of the United States District Court for the Middle District of Pennsylvania, which was affirmed by the Third Circuit Court of Appeals, is in direct conflict with the Tenth Circuit Court of Appeals in In Re: B&L Oil Company, supra.

Respectfully submitted,



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Attorneys for Petitioners

CERTIFICATE OF SERVICE

AND NOW, this 29th day of March, 1990, I, Jeannine Turgeon, Esquire, a member of the law firm of Davis & Turgeon, attorneys for Petitioners, hereby certify that I this date served the within corrected Petition for Writ of Certiarori by depositing three (3) copies of same in the United States Mail, postage prepaid, at Harrisburg, Pennsylvania, addressed to the attorney or party of record as follows:

John W. Frommer, III, Esquire
Smigel, Anderson & Sacks
2917 North Front Street
Harrisburg, Pennsylvania 17110
(717) 234-2401

Jeannine Turgeon

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

HERBERT E. RUBIN, and PACKAGING EQUIPMENT SYSTEMS, INC. Plaintiffs	:	
vs.	:	CIVIL ACTION NO. 88-0920
TESLA PACKAGING, INC. ORION PACKAGING, INC. and JACEK MUCHA, individually Defendants	:	

M E M O R A N D U M

This matter is before the court on a stipulation of facts, for the purpose of establishing the status of claims made against each other by Packaging Equipment Services (PES) and Orion Packaging, Inc. (ORION).

Orion is a manufacturer of a line of packaging equipment. PES was engaged in the business of selling machinery and from time to time sold equipment manufactured by Orion. Between August of 1985 and August

26, 1986 (the date PES filed for bankruptcy protection under Chapter 11) PES sold four (4) Orion machines to Northland Container Corporation, of Michigan. During this period it was arranged between PES and Orion that PES would bill the customer for the full price and thereafter forward to Orion the selling price less PES's commission. The last sale prior to bankruptcy occurred in March 1986 and on June 27, 1986 PES billed Northland. On August 25, 1986, Northland issued a check in the sum of $49,292.80 in payment and the next day, on August 26, 1986, PES filed its petition. The proceeds of Northland's check became part of the assets of the PES bankruptcy proceeding. [1]

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1. The stipulation does not specify when Northland's check was actually received by PES, but we assume it was not before the filing of Chapter 11 petition. The obligation to Orion is included by PES in its schedule of debts.

The Parties agree that included in Northland's payment of $49,292.80 was the sum of $30,078.00 that PES owed Orion on account of the selling price for the machine in question. We assume that had it not been for the Chapter 11 filing, PES would have remitted what it owed Orion from the payment received from Northland.

After August 26, 1986, and between November of 1987 and March of 1988, PES and Orion did business together but their arrangement changed. PES continued to sell equipment made by Orion, but during this period of time Orion billed PES's customer and accrued the commissions earned by PES. It is agreed that presently Orion owes commissions to the bankrupt's estate in the sum of $30,738.00.

The issue presented is whether Orion can set-off or recoup its obligation to the bankrupt estate for commissions, by deducting the amount PES owed to it when the bankruptcy proceeding was filed. If a set-off or recoupment is allowed the parties agree that the result is a wash. If a set-off or recoupment is unavailable to Orion then it has agreed to pay to the trustee its obligation to PES, and the funds will be distributed to creditors. [2]

We conclude that Orion cannot recoup what it was owed by PES when the latter filed its Chapter 11 proceeding, and that Orion must pay to the trustee the commissions earned by PES subsequent to August 26, 1986.

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2. The Chapter 11 filing was converted to a Chapter 7 proceeding on September 26, 1988.

This outcome is mandated by the holding of Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland, 63 B.R. 18 (1986), in which the same scenario was present. In Westinghouse, supra, Enviro-Scope

Corporation sold office equipment as a dealer for Westinghouse. As with this case, the parties had arranged that Enviro-Scope would bill its customer in full, and would remit to Westinghouse. Enviro-Scope fell behind in its obligations to Westinghouse and the arrangement was changed, so that Westinghouse billed the customer directly and accrued the commission earned by Enviro-Scope. Westinghouse then applied the commission to reduce Enviro-Scope's obligation to it. Enviro-Scope filed a Chapter 11 proceeding on April 1, 1985, and Enviro-Scope and Westinghouse continued with

their arrangement. Eventually Westinghouse recouped in full what it was owed by Enviro-Scope. Enviro-Scope later filed an adversary proceeding against Westinghouse to recover the commissions withheld by Westinghouse that were earned after April 1, 1985. On motion of Westinghouse the adversary proceeding was withdrawn from the bankruptcy court and submitted for decision to the District Court for the Eastern District of Pennsylvania.

Judge McGlynn held that Westinghouse could not withhold or set-off the commissions earned by Enviro-Scope after it filed its Chapter 11 petition. In recognizing the equitable principle of recoupment as an exception to the general rule which prohibits the set-off of pre-bankruptcy debt, Judge McGlynn applied the established rule that recoupment is permitted only where the amount sought to be

recouped by the creditor arises from "the same transaction" on which the debtor's claim is based. In the Westinghouse case, as here, the reciprocal obligations arose from different transactions:

> The fact that the same two parties are involved, and that a similar subject matter gave rise to both claims ... does not mean that the two arose from "the same transaction." (p.21)

As suggested by Judge McGlynn in dealing with the facts in Westinghouse, PES or Orion could have terminated their arrangement when the bankruptcy proceeding was filed (or at any time for that matter) and the amount owed Orion would have been discharged in the bankruptcy. Judge McGlynn astutely observed that this result should not differ merely because PES continued to earn commissions after it declared bankruptcy. It is true PES benefitted, but Orion had nothing to lose and provided no further credit to PES. Echoing Judge

McGlynn, it would be improper to permit Orion to accrue an indebtedness to PES in order to create a charge against a pre-existing debt of PES, and thus obtain a preference over other unsecured creditors.

We have reviewed the decisions relied upon by Orion where recoupment was allowed but they are easily distinguishable. They all involve instances where the debt recouped by the creditor was an integral or indivisible part of the claim made by the bankrupt, or was a recognized exception where the creditor has inadvertently overpaid the debtor, and is permitted to recoup the overpayment for which there was no consideration in the first instance. These circumstances existed in In re B & 1 Oil Co., 782 F.2d 155 (10th Cir. 1986); in re Monsour Medical Center, 11 B.R. 1014 (W.D. Pa. 1981); In re Yonkers Hamilton Sanitarium Inc., 22 B.R. 427 (Bankr. S. D.

N.Y. (1982)); and In re American Central Airlines, Inc., 60 B.R. 587 (Bankr. N.D. Iowa (1986)). In other cases contractors were permitted to recoup breach of contract claims, or supplier's claims, against claims for balances due to bankrupt sub-contractors. See In re Clowards, Inc., 42 B.R. 627 (Bankr. D.Idaho (1984)) and In re Alpco, Inc., 62 B.R. 184 (Bankr. S.D. Ohio (1986)). An oil field operator was allowed to recoup the cost of producing oil from a claim made for the proceeds realized from the sale of the oil. See In re Buttes Resources Co., 89 B.R. 613 (S.D. Texas (1988)). In Matter of Pa. Tire Company, 26 B.R. 663 (Bankr. N.D. Ohio (1982)), a breach of warranty defense was permitted to be raised against the debtors claim for the purchase price due for tires.

None of these circumstances exist here, and the PES pre-filing debt to Orion is

totally unconnected to the commissions earned by PES on post filing sales. To permit Orion to recoup its claim would be to give it preferential treatment over other unsecured creditors and would be contrary to the general rule against set-offs in bankruptcy (11 U.S.C. section 553)

An appropriate order will be entered herein.

William W. Caldwell
United States District Judge

Dated: June 27, 1989

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

HERBERT E. RUBIN, and PACKAGING EQUIPMENT SYSTEMS, INC., Plaintiffs	:	
vs.	:	CIVIL ACTION
	:	NO. 88-0920
TESLA PACKAGING, INC., ORION PACKAGING, INC., and JACEK MUCHA, individually, Defendants	:	

ORDER

AND NOW, this 27th day of June, 1989, it is ordered pursuant to the agreement of the parties that judgment be entered in favor of Packaging Equipment Systems, Inc., and against Orion Packaging, Inc., in the sum of $30,738.00, without interest, costs to be shared by the parties.

The Clerk of Court is directed to close this file.

William W. Caldwell
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

HERBERT E. RUBIN and PACKAGING EQUIPMENT SYSTEMS, INC. Plaintiffs	:	CIVIL ACTION
vs.	:	NO. CV 88-0920
TESLA PACKAGING, INC., ORION PACKAGING, INC. and JACEK MUCHA, individually Defendants	:	(JUDGE CALDWELL)

STIPULATED FACTS

1. P.E.S. sold at least four Orion packaging machines to Northland Container between the time the parties entered their business agreement in August, 1985 and the time P.E.S. filed its Chapter 11 Petition on August 26, 1986. (See Invoices, Purchase Orders and payments for sales to Northland Container attached hereto as Exhibit 1).

2. In each sale, as with other P.E.S. customers, P.E.S. sent an invoice to

Northland Container for Northland's purchase of Orion equipment and P.E.S. received payment from Northland Container.

3. After 30 days from shipment, P.E.S. would pay Orion the manufacturer's cost of the machine plus shipping charges and keep the remaining monies as their profit/commission.

4. Northland was a regular customer of P.E.S.

5. On March 12, 1986, Northland Container wrote to Mr. Rubin, President of P.E.S., and enclosed a purchase order for the purchase of Orion equipment in the amount of $90,060.00. The letter referenced a downpayment of $10,000.00 to P.E.S. and $20,000.00 to Orion. (See letter, purchase order and downpayment checks attached hereto as Exhibit 2).

6. P.E.S. invoiced Northland Container for the equipment on June 27,

1986. The equipment was fully automatic stretch wrapping machines. (See P.E.S. invoice attached hereto as Exhibit 3).

7. Northland Container sent P.E.S. a payment of $49,292.80 representing payment of P.E.S. invoice of June 27, 1986 less deductions and withholding of $10,767.20, as evidenced by a check and memo dated August 25, 1986. (See memo-letter to P.E.S. from Northland Container and check attached hereto as Exhibit 4).

8. The $49,292.80 received by P.E.S. was reported to the Bankruptcy Court on the P.E.S. monthly financial statement for August, 1986 as a "Collection of Pre-Chapter 11 Receivables". (See monthly bankruptcy report for August 1986 attached hereto as Exhibit 5).

9. The parties agree that of the $49,292.80 received by P.E.S. from Northland, P.E.S. owed Orion $30,078.00.

The $49,292.80 received by P.E.S. from Northland Container was reported to the Bankruptcy Court by P.E.S. as a pre-bankruptcy account receivable, was not paid to Orion and has been claimed by Orion as a Counterclaim to the P.E.S. Complaint.

10. Under the parties business agreement, the method used by both P.E.S. and Orion for calculating the profit/commission P.E.S. would receive on the sale of Orion equipment was to take the retail sales price of the machine and subtract the manufacturer's (Orion's) cost of the machine and shipping charges. After the Chapter 11 bankruptcy petition was filed, customs duties were also deducted from the retail sales price on non-automatic machines in arriving at the P.E.S. profit/commission.

11. As a general rule, from the onset of the parties business agreement up to the

filing of the Chapter 11 petition by P.E.S., P.E.S. would invoice the purchaser of Orion equipment, receive payment for the equipment from the purchaser, and then pay Orion the manufacturer's cost for the equipment, plus shipping. P.E.S. would retain the remaining portion of the retail sales price as its profit/commission. (See Mucha deposition, p. 25, l. 29-24).

12. As a general rule, after P.E.S. filed bankruptcy, Orion would invoice the purchaser of Orion equipment directly, receive payment for the retail sales price directly from the purchaser, retained its cost and shipping charge and send P.E.S. its profit/commission for the sale. (See Mucha deposition, p. 25, l. 19-24).

13. The retail or sales price of Orion packaging machines sold by P.E.S. was always determined by P.E.S.

14. The claims by P.E.S. against Orion for unpaid commissions all arise from transactions or sales which occurred between November 1987 and March 1988.

15. On September 26, 1988, P.E.S. converted its Chapter 11 bankruptcy to a Chapter 7. Smigel, Anderson and Sacks were retained by the trustee to proceed with the instant lawsuit against Orion. Any funds recovered as a result of this suit by P.E.S. shall be paid to the trustee, and subsequently distributed to secured Chapter 7 creditors.

DAVIS & TURGEON

by: _____
James W. Abraham, Esquire
130 State Street
Harrisburg, PA 17101
Attorney for Defendant

SMIGEL, ANDERSON & SACKS

by: _____
John W. Frommer, Esquire
2917 North Front Street
Harrisburg, PA 17110-1223
Attorney for Plaintiff

... bankruptcy filing on August 26 of 1986 which dealt with the Northland Container account?

A Well, there was a change, but that was generated by the Northland themselves.

Q And the change was that you, Orion Packaging, Inc., would bill Northland directly from a certain point on and would not pay Packaging Equipment Systems any profit on those sales to Northland, is that correct?

A When Northland decided to deal directly directly with us because he was disappointed with the performance of PES.

Q Did you and any representatives from Packaging Equipment Systems discuss transferring the Northland account from Packaging Equipment Systems to Orion in an effort to recover any pre-petition Orion debt?

A In fact, I had some situation when PES was quite unhappy with the fact that we were invoicing Northland directly and not submitting any records of that to them and they call -- I mean I did not say that for certain, but it seems to me like a call was made to Northland Container asking for the records of all dealings with Orion Packaging, Inc. Montreal and that was the way I believe the information about our dealing with them was obtained.

Q My question was, did you and anyone from packaging Equipment Systems discuss Orion Packaging, Inc. taking over the Northland account in order to avoid paying a profit on future ...

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 89-5637

HERBERT E. RUBIN and
PACKAGING EQUIPMENT SYSTEMS, INC.

v.

TESLA PACKAGING INC.;
ORION PACKAGING INC. and JACEK MUCHA,

Appellants

On Appeal from the United States District Court for the Middle District of Pennsylvania (Scranton)
(D.C. Civil No. 88-0920)
District Judge: William W. Caldwell

Submitted Under Third Circuit Rule 12(6)
December 14, 1989

Before: HUTCHINSON, COWEN and WEIS,
Circuit Judges

JUDGMENT ORDER

After consideration of the contentions

raised by appellants, it is

ADJUDGED AND ORDERED that the judgment of the district court be and is hereby affirmed. Cost taxed against the appellants.

ATTEST: By the Court,

_____ _____
Sally Mvros, Clerk CIRCUIT JUDGE

Dated:_____

UNITED STATES SUPREME COURT

HERBERT E. RUBIN PACKAGING EQUIPMENT SYSTEMS, INC.,	:	
Appellees	:	NOTICE OF APPEAL
v.	:	
	:	DOCKET NO. 89-5637
TESLA PACKAGING, INC., ORION PACKAGING, INC., and JACEK MUCHA,	:	
Appellants	:	

From a judgment and Order of the Third Circuit Court of Appeals:

NOTICE OF APPEAL

Notice is hereby given that Appellants above, hereby appeal to the United States Supreme Court from the Final Judgment Order entered in this action on the 21st day of

December, 1989, pursuant to Title 28 U.S.C.A. section 1254.

Respectfully submitted,

DAVIS & TURGEON

By:_____
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I.D. No.
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P. O. Box 1000
Harrisburg, PA 17108
(717) 232-1876

Attorneys for Appellants

Dated:

UNITED STATES SUPREME COURT

HERBERT E. RUBIN and PACKAGING EQUIPMENT SYSTEMS, INC.,	:	
Appellees	:	NOTICE OF APPEAL
v.	:	
	:	DOCKET 89-5637
TESLA PACKAGING, INC., ORION PACKAGING, INC., and JACEK MUCHA,	:	
Appellants	:	

CERTIFICATE OF SERVICE

AND NOW, this _____ of March, 1990, I, JEANNINE TURGEON, ESQUIRE, a member of the law firm of Davis & Turgeon, attorneys for Appellants, hereby certify that I served the within Notice of Appeal by depositing a copy of same in the United States Mail, postage prepaid, at Harrisburg, Pennsylvania, addressed to the attorney or party of record as follows:

John W. Frommer, Esquire
2917 North Front Street
Harrisburg, Pennsylvania 17110

_____
Jeannine Turgeon, Esquire

PETITIONERS' CORPORATION STATEMENT
(Pursuant to Supreme Court Rule 29.1)

There are no parent corporations or subsidiary companies as to Respondent, Tesla Packaging, Inc., and Respondent, Orion Packaging, Inc.

No. 89-1534

In The

Supreme Court of the United States

October Term, 1989

TESLA PACKAGING INC., ORION PACKAGING, INC. and JACEK MUCHA,

Petitioners,

vs

HERBERT E. RUBIN and PACKAGING EQUIPMENT SYSTEMS, INC.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Petition for Writ of Certiorari alleging a "conflict" between Circuit Court decisions lacks merit, where the Third Circuit Court in this case denied recoupment under Pennsylvania law of pre-bankruptcy petition claims from post-petition claims found to be unconnected and to have arisen from different transactions, while the factually distinguishable Tenth Circuit decision concerned a single contract and followed a narrow, recognized exception permitting recoupment of mistaken overpayments?

Suggested Answer: The Petition for Writ of Certiorari lacks merit.

RESPONDENTS' CORPORATION STATEMENT
(Pursuant to Supreme Court Rule 29.1)

The parent corporation of Respondent Packaging Equipment Systems, Inc. is Rubin Enterprises, Inc.

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STATEMENT OF THE CASE

a. Procedural posture.

This action arose in connection with a proceeding under Chapter 11 of the United States Bankruptcy Code styled *In Re: Packaging Equipment Systems, Inc.*, No. 1-86-00885, Middle District of Pennsylvania, which was filed on August 26, 1986. The Respondents in the instant case filed a complaint against Petitioners in the United States District Court, Middle District of Pennsylvania on June 16, 1988, Docket No. 88-00920. On August 25, 1988, the Petitioners filed their Amended Answer with Affirmative Defenses and Counterclaims. Pretrial memoranda were filed by both parties on May 2, 1989 and Supplemental Pretrial Memoranda were filed by both parties; Respondent's was filed on May 10, 1989 and Petitioner's on May 15, 1989. On June 5, 1989, the parties submitted Stipulated Facts to the Court.

On June 27, 1989, Judge William W. Caldwell issued a Memorandum Opinion and Order. The Order directed that judgment be entered in favor of the Respondents in the amount of $30,738.00, without interest, costs to be shared by the parties.

On June 27, 1989, Petitioners filed a Notice of Appeal in the United States District Court for the Middle District of Pennsylvania. On August 3, 1989, the Third Circuit Court of Appeals docketed Petitioner's appeal as No. 89-5637. By Judgment Order dated December 21, 1989, the Third Circuit Court of Appeals affirmed the decision of the United States District Court for the Middle District of Pennsylvania and awarded costs to the Respondents. Petitioners filed this appeal to the United States Supreme

Court from the Judgment Order of the Third Circuit Court of Appeals.

On March 21, 1990, Petitioners filed a Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit. The original Petition was returned for nonconformity and a second Petition was filed on March 28, 1990. This Brief is filed in Opposition to said Petition for Writ of Certiorari.

b. Statement of Facts.

This action arises in connection with a proceeding under Chapter 11 of the United States Bankruptcy Code titled *In Re: Packaging Systems, Inc.*, No. 1-86-00885, Middle District of Pennsylvania, which was filed on August 26, 1986. Packaging Equipment Systems, Inc. (hereinafter referred to as "PES") is a Pennsylvania corporation which at all times relevant to this action sold packaging equipment and supplies throughout the United States. In August of 1985, PES, through its President, Herbert E. Rubin, entered into an oral business arrangement with Petitioner, Orion Packaging, Inc. (hereinafter "Orion"), a Canadian Corporation which manufactures packaging machines through its President, Petitioner Jacek Mucha. Both parties have agreed that there existed an oral agreement providing that PES would receive a profit on sales of Orion equipment in the United States generated by PES. Under the parties' business agreement, the method used by both PES and Orion for calculating the profits/commissions PES would receive on the sales of the Orion equipment was to take the retail sales price of the machine and subtract the manufacturer's (Orion's) cost of

the machine and shipping charges. (Stipulated Fact No. 10, appendix to Petition for Writ of Certiorari, hereinafter "App.", p. 16a).

Between August of 1985 and August 26, 1986 (the date PES filed for bankruptcy protection under Chapter 11), PES sold four Orion machines to Northland Container Corporation of Michigan. (Stipulated Fact No. 1, App. at 13a). During this period it was arranged between PES and Orion that *PES would invoice* the purchasers of Orion equipment, receive payments for the equipment from the purchasers, and then pay Orion the manufacturer's cost for the equipment, plus shipping. PES would retain the remaining portions of the retail sales prices as its profits/commissions. (Stipulated Fact No. 11, App., pp. 16a-17a). The last sale prior to bankruptcy occurred in March 1986 and on June 27, 1986 PES billed Northland. (Stipulated Fact No. 6, App., pp. 14a-15a). On August 25, 1986 Northland issued a check in the sum of $49,292.80 in payment and the next day, on August 26, 1986, PES filed its petition. The proceeds of Northland's check became part of the assets of the PES bankruptcy proceeding. (Stipulated Fact No. 8, App., p. 15a).

The parties agree that included in Northland's payment of $49,292.80 was the sum of $30,078.00 that PES owed Orion on account of the selling price for the machine in question. (Stipulated Fact No. 9, App., pp. 15a-16a).

After PES filed for bankruptcy under Chapter 11 on August 26, 1986, the parties agreed to the continuation of their business arrangement, although Orion required certain modifications to the parties' business arrangement.

Specifically, Orion required PES to assume responsibility for the payment of customs duties on Orion equipment shipped into the United States. In addition, after PES filed bankruptcy, *Orion began to invoice* the purchasers of Orion equipment directly, receive payments for the retail sales prices directly from the purchasers, retain its costs and shipping charges and send PES its profits/commissions for the sales (Stipulated Fact No. 12, App., p. 17a). The first modification served to reduce the PES profits/commissions by shifting the custom duty costs from Orion to PES. The second modification shifted financial control over invoicing to Orion. Orion required that invoicing of United States customers be done directly from Orion's headquarters in Canada rather than by PES.

The business relationship between the parties was nonetheless financially successful during this period of time. PES, through its marketing and sales efforts, generated substantial and growing sales of Orion equipment in the United States to various purchasers.

It was during this period of time, however, that Orion began to withhold payment of PES's profits on a number of United States sales. It is the profits/commissions on these post-bankruptcy sales for which PES sued. (Stipulated Fact No. 14, App., p. 18a).

SUMMARY OF ARGUMENT

The Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit, hereinafter "Petition," lacks merit. The Petition is based upon an

alleged "conflict" between the decision of the Third Circuit Court of Appeals in this case and the clearly distinguishable decision of the Tenth Circuit Court of Appeals in *In Re: B&L Oil Company*, 782 F.2d 155 (10th Cir. 1986) (*See*, Petition, p. 15). There is no conflict between these decisions.

The clearly distinguishable facts of the two cases establish why recoupment might have been permissible in *B&L*, while recoupment would not be proper in this case. *B&L* involved a *single* contract and followed a narrow, recognized exception permitting recoupment of mistaken overpayments. The Honorable William W. Caldwell, at the district level, distinguished *B&L* and all of the other cases cited by Petitioners as involving "instances where the debt recouped by the creditor was an integral or indivisible part of the claim made by the bankrupt, or was a recognized exception where the creditor had inadvertently overpaid the debtor, and is permitted to recoup the overpayment for which there was no consideration in the first instance." (App., p. 8a).

In contrast to *B&L*, there were no "overpayments" by Orion to PES in this case. Rather, PES owed Orion the selling price of a machine sold before the bankruptcy petition was filed. Furthermore, there was no "single contract" in this case as in *B&L*. Respondents maintain that each individual sale of equipment to each of numerous purchasers in the course of dealings between the parties constituted separate transactions. In any event, it is undeniable that the claims of PES and Orion arose from *at least two* different series of transactions – those which

occurred *before* Orion changed the sales and billing arrangements and those which occurred afterwards. There was no "single contract" as in *B&L*.

The district court so held, finding as facts that the parties' reciprocal obligations "arose from different transactions," (App., p. 7a), and that the PES pre-filing debt to Orion was "totally unconnected to the commissions earned by PES on post filing sales." (App., pp. 9a-10a). The Third Circuit Court of Appeals affirmed the district court's decision. Petitioners are, in essence, asking this Court to ignore or overrule the factual findings in this case and apply the inapplicable decision of *B&L*.

Respondents are compelled by Supreme Court Rule 15.1 to point out perceived misstatements by the Petitioners. Petitioners misstate the facts by representing to this Court that "there were no material changes throughout the business arrangement between Petitioner and Respondent. . . ." (Petition, p.11). One can hardly imagine a more significant change in the business relationship than the handling of billings and payments. In essence, the parties' business relationship changed from one where PES billed purchasers, forwarded the manufacturer's cost plus shipping to Orion, and kept the remaining monies as PES profit/commission (Stipulated Facts, Nos. 3, 11, App., pp. 14a, 16a-17a), to an Orion-controlled relationship where Orion generally invoiced purchasers directly, received payment from the purchasers directly, retained its costs and shipping charges, and was to send PES its profit/commission for the sales (Stipulated Fact No. 12, App., p. 17a). In a bankruptcy situation, where so

much hinges upon which party has the assets at the time of the bankruptcy, a change in the handling of billings and payments is most significant.

Petitioners misstate the law applicable to this case by representing to this Court that the doctrine of recoupment is to be applied when pre-petition claims and post-petition claims "arose from the same transaction or *cause of action*." (Petition, pp. 11, 12) (Emphasis added). Petitioners misstate the question for review as whether the doctrine of recoupment is applicable where "a creditor's pre-petition claim against a bankrupt debtor and a debtor's post-petition claim against a creditor *are deemed to have arisen from the same transaction or cause of action. . . .*" (Petition, p. i) (Emphasis added). *No one* (but the Petitioners) has "deemed" these claims to have arisen from the same transaction. To the contrary, these claims have been found as a matter of fact to be totally unconnected and to have arisen from different transactions. (App., pp. 7a, 9a-10a). Further more, *no one* (but the Petitioners) has "deemed" that any claim which merely arises from the same "cause of action" may be recouped. To the contrary, the law precludes Orion from recouping its claim because it did not arise from the *same transaction* as did PES's claim.

Petitioners argue that *B&L* "recognized the equitable aspects of the doctrine of recoupment in that a debtor-in-possession, that accepts the benefits of an executory contract, cannot do so without accepting the burdens." (Petition, p. 19). Again, this case does not involve mere overpayments, or a single contract, nor does it involve an executory contract. It involves distinct transactions which occurred on opposite sides of the "cleavage in time"

created by the bankruptcy petition. Furthermore, the Honorable William W. Caldwell did consider the equities in this case at the district court level and reasoned:

> As suggested by Judge McGlynn in dealing with the facts in *Westinghouse*, PES or Orion could have terminated their arrangement when the bankruptcy proceeding was filed (or at any time for that matter) and the amount owed Orion would have been discharged in the bankruptcy. Judge McGlynn astutely observed that this result should not differ merely because PES continued to earn commissions after it declared bankruptcy. It is true PES benefitted, but Orion had nothing to lose and provided no further credit to PES. Echoing Judge McGlynn, it would be improper to permit Orion to accrue an indebtedness to PES in order to create a charge against a pre-existing debt of PES, and thus obtain a preference over other unsecured creditors.

(App., pp. 7a-8a) (Citing *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986)). Judge Caldwell clearly considered the equitable factors in this case even though this case did not involve a single, executory contract as in *B&L*. Judge Caldwell properly held that a recoupment could not be permitted.

The factual disparities between this case and *B&L* justify their respective holdings. There is no conflict between these cases, and the Petition for Writ of Certiorari has no basis.

Respondent would only add that even if there *were* some conflict between this case and *B&L*, that recoupment being a common law doctrine, *Lee v. Schweiker*, 739

F.2d 870, 875 (3rd Cir. 1984), the common law of Pennsylvania would apply rather than *B&L* which is a Colorado case. The law which Pennsylvania has adopted regarding recoupment is set forth in *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D. Pa. 1986), a case which is factually "on all fours" with the case at bar and which was cited as controlling by the district court. (App., p. 5a).

ARGUMENT

a. The Petition for Writ of Certiorari lacks merit because there is no conflict between the decision of the Third Circuit Court of Appeals in this case and the clearly distinguishable decision of the Tenth Circuit Court of Appeals in *In Re: B&L Oil Company*, 782 F.2d 155 (10th Cir. 1986).

The Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit (hereinafter "Petition") lacks merit. Petitioners have failed to allege any special and important reasons for reviewing this matter on Writ of Certiorari.

The Petition is based upon an alleged "conflict" between the decision of the Third Circuit Court of Appeals in this case and a clearly distinguishable decision of the Tenth Circuit Court of Appeals in *In Re: B&L Oil Company*, 782 F.2d 155 (10th Cir. 1986) (*See*, Petition, p. 15). There is no conflict between these circuit court decisions. The clearly distinguishable facts of the two cases readily establish why recoupment might have been permissible in *B&L* while recoupment would not be proper in this case.

B&L involved two parties to an oil division order, by which the creditor, Ashland Petroleum Company, received the right to purchase unspecified amounts of crude oil that B&L produced. *B&L*, 782 F.2d at 156. Ashland overpaid B&L for oil which had been produced and delivered prior to the filing of the bankruptcy petition. After the bankruptcy petition had been filed, Ashland withheld payments for post-petition oil deliveries to try to recover its mistaken overpayments to B&L. The Tenth Circuit Court of Appeals recognized that any recoupment exception to the general principal that pre-petition bankruptcy debts may not be satisfied through post-petition transactions should be narrowly construed. *Id.* at 158. However, the Tenth Circuit permitted recoupment in *B&L* because the amounts to be recouped were mistaken overpayments and fell within a line of cases permitting recoupments of such mistaken overpayments. *Id.* at 158-159.

In the case at bar, there were no overpayments, mistaken or otherwise. The Honorable William W. Caldwell, at the district court level, distinguished *B&L* and all of the other cases cited by Petitioners as involving "instances where the debt recouped by the creditor was an integral or indivisible part of the claim made by the bankrupt, or was a recognized exception where the creditor has inadvertently overpaid the debtor, and is permitted to recoup the overpayment for which there was no consideration in the first instance." (App., p. 8a). In this case, the District Court determined that the reciprocal claims of Petitioners and Respondents "arose from different transactions," (App., p. 7a), and that the PES pre-

filing debt to Orion was "totally unconnected to the commissions earned by PES on post-filing sales." (App., pp. 9a-10a). In essence, Petitioners are asking this Court to ignore or overrule the factual findings in this case and apply the inapplicable decision of *B&L*. The District Court's findings of fact were clearly proper and are not subject to being overturned.

There are other facts distinguishing this case from *B&L*. Unlike *B&L*, each individual sale of equipment to each individual purchaser in the course of dealings between these parties constituted a separate and unrelated transaction. Unlike *B&L*, each transaction involving Petitioners and Respondents involved different pieces of equipment to different third parties. Each sale was unique and unrelated to any other sale. In contrast, in *B&L* creditor Ashland bought a fungible good directly from debtor B&L. There were no third parties, and the product being sold was always oil. Unlike *B&L*, the course of dealings between Orion and PES drastically changed after the filing of the bankruptcy petition.

Orion's unilateral alterations of the transactions following the bankruptcy petition constituted substantially more than a mere change in "office process" as Petitioners would have this Court believe. (*See*, Petition, p. 8). The parties' business relationship changed from one where PES billed purchasers, forwarded the manufacturer's cost plus shipping to Orion, and kept the remaining monies as PES's profit/commission (Stipulated Facts Nos. 3, 11, App., pp. 14a, 16a-17a), to an Orion-controlled relationship where Orion generally invoiced purchasers directly, received payment from the purchasers directly, retained its costs and shipping charges, and was to send

PES its profit/commission for the sales (Stipulated Fact No. 12, App., p. 17a). In a bankruptcy situation, where so much hinges upon which party has the assets at the time of the bankruptcy, a more significant change in business relationships can hardly be imagined. While Respondents maintain that each sale constituted a separate transaction, it is undeniable that there were *at least two* different series of transactions – those which occurred *before* Orion changed the sales and billing arrangement and those which occurred afterwards.

Pursuant to Supreme Court Rule 15.1, Respondents are compelled to point out that not only have Petitioners misstated the facts by representing to this Court that "there were no material changes throughout the business arrangement between Petitioner and Respondent . . . " (Petition, p. 11), but they have additionally misrepresented the law. Petitioners state, " . . . the post-bankruptcy sales of Respondent should be construed as emanating from the same transaction *or cause of action*, thereby allowing recoupment of Petitioners' pre-petition claims against Respondents' post-petition claims". (Petition, p. 19) (Emphasis added). Again, in their question for review, Petitioners suggest that recoupment is to be applied when "a creditor's pre-petition claim against a bankrupt debtor and a debtor's post-petition claim against a creditor are deemed to have arisen from the same transaction *or cause of action* . . . " (Petition, p. i) (Emphasis added). Petitioners' argument makes no sense. A claim can arise from the same "cause of action" without arising from the "same transaction." If Petitioners' argument was correct, pre-petition obligations could be recouped from post-petition obligations arising from different transactions and the doctrine of set-off adopted

by the Bankruptcy Code at Section 553, 11 U.S.C. § 553, would be rendered practically meaningless. There would be no need to limit set-off to pre-petition claims.

Clearly Petitioners' argument misstates the law. The law does *not* permit recoupment of claims which have merely arisen from the same cause of action, as Petitioners argue. To the contrary, *Collier on Bankruptcy* states that recoupment is, "the setting up of a demand arising from the *same transaction as* the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim." *4 Collier on Bankruptcy*, Section 553.03 at page 553-13 (15th Ed. 1988) (Note omitted) (Some emphasis added). The doctrine of recoupment strictly requires that the claims arise from the same *transaction*, not just the same "cause of action": "Recoupment has thus been traditionally applied narrowly and is restricted to the *precise same transaction* in which the claim is made." *In Re Melvin*, 75 B.R. 952, 959 (Bkrtcy. E.D.Pa. 1987) (Emphasis added) (Citations omitted). Orion cannot recoup its claim because its claim did not arise from the *same transaction* as did PES's claim.

In the district court, having found that the parties' reciprocal obligations were totally unconnected and arose from different transactions (App., pp. 7a, 9a-10a), Judge Caldwell properly refused to permit a recoupment by Orion because it would give Orion an improper preferential treatment over the other creditors in violation of 11 U.S.C. Section 553 (App., p. 10a).

Petitioners suggest that the *B&L* court, "recognized the equitable aspects of the doctrine of recoupment in that a debtor-in-possession, that accepts the benefits of an

executory contract, cannot do so without accepting the burdens." Petitioners point out that Orion was the only creditor with whom Respondents continued to do business after filing the bankruptcy petition. (*See*, Petition, p. 19). Again, Petitioners misstate the facts by suggesting that this case involves a single contract or an executory contract. But furthermore, the Honorable William W. Caldwell fully considered the equities of this case at the district level, and he reasoned:

> As suggested by Judge McGlynn in dealing with the facts in *Westinghouse*, PES or Orion could have terminated their arrangement when the bankruptcy proceeding was filed (or at any time for that matter) and the amount owed Orion would have been discharged in the bankruptcy. Judge McGlynn astutely observed that this result should not differ merely because PES continued to earn commissions after it declared bankruptcy. It is true PES benefitted, but Orion had nothing to lose and provided no further credit to PES. Echoing Judge McGlynn, it would be improper to permit Orion to accrue an indebtedness to PES in order to create a charge against a pre-existing debt of PES, and thus obtain a preference over other unsecured creditors.

(App., pp. 7a-8a) (Citing *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986)). Judge Caldwell clearly considered the equitable factors in this case even though this case did not involve a single, executory contract as did *B&L*. Judge Caldwell properly held that a recoupment could not be permitted.

The factual disparities between this case and *B&L* justify their respective holdings. There is no conflict between these cases and the Petition for Writ of Certiorari has no basis.

b. Even if there were any conflict between this decision and the decision of another Federal Court of Appeals, recoupment is a common law doctrine, and the law of Pennsylvania as set forth in *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986) is controlling.

As discussed in section "a" above, the source of Petitioners' discontent is the findings of fact by the District Court, affirmed by the Third Circuit Court of Appeals, that the parties' reciprocal claims arose from different transactions and were completely unrelated. However, to the extent that Petitioners argue that there is any conflict between the law as set forth in this case and *B&L*, they are asking this Court to overrule the common law of Pennsylvania in favor of that of Colorado. The *Erie* doctrine is axiomatic: there is no federal general common law and our federal courts apply the common law of the state. *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). Unlike "set-off", the doctrine of recoupment was a common law doctrine which was adopted by decision rather than statute. *Lee v. Schweiker*, 739 F.2d 870, 875 (3rd Cir. 1984). Thus, in this case, it is Pennsylvania's common law of recoupment which applies rather than Colorado's common law. The law which Pennsylvania has adopted regarding recoupment is as set forth in *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986),

a case which is factually "on all fours" with the case at bar and which was cited as controlling by the District Court. (App., p. 5a).

Judge Caldwell clearly and thoroughly reviewed the *Westinghouse* case in his Memorandum. The Appellants have not cited any contrary Pennsylvania authority, and Judge Caldwell found the *B&L* case to be factually distinct from this case. (*See*, App., p. 8a). Judge Caldwell properly applied the Pennsylvania law as set forth in *Westinghouse* to this case, rather than the law of Colorado as set forth in the factually distinguishable case of *B&L*.

CONCLUSION

WHEREFORE, Respondent prays that this Honorable Court deny the Petition for Writ of Certiorari.

Respectfully submitted,

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